

SECRET

IDEA-0164-61
Copy 1 of 5

8 February 1961

MEMORANDUM FOR: Acting Chief, DPD

SUBJECT : Compensation for Additional Work Performed by
Eastman Kodak Company under Contract EQ-1806

25X1A 1. In your memorandum to the General Counsel dated 30 December 1960 you requested the opinion of our Office as to the legality of a proposed payment of [] to the Eastman Kodak Company in full and final settlement of Contract EQ-1806. We have carefully reviewed the entire contract file which you furnished us and which covers the history of this matter from its inception in 1956.

25X1A 2. It is the opinion of this Office, as more fully explained below, that the Government does have an obligation to make a further payment to Eastman under this contract. Determining the appropriate amount of such a payment is a matter of fact rather than of law, but our review leads us to conclude that the amount of [] is an appropriate sum for the Government to offer the Contractor in complete settlement. In order to bring this matter to a conclusion, we suggest that you advance this recommendation to the Director, citing the references listed below and this opinion in support of your proposal. 1/

Statement of the Problem

25X1A 3. The Eastman Kodak Company has requested an additional payment beyond the contract ceiling price to cover costs arising from additional work performed under Contract EQ-1806. This contract was executed on 1 March 1956 and had a maximum fixed price stated as []. This contract was to provide the Agency with equipment in support of IDEALIST, namely (i) plant equipment for the Agency's special film processing facility at Rochester, N.Y., and (ii) Minicard equipment for installation in the Agency's Photographic Intelligence Center (PIC). In addition Minicard equipment was to be produced for installation in the Agency's Office of Central Reference. It is with respect to the two Minicard equipment installations, fixed-priced in the contract at a total of [] that the Company has incurred the very large costs which it now desires to recoup in part. Costs related to the Rochester, N.Y. facility are not in issue.

25X1A 4. Excess Cost Data. Eastman books reflect a total cost for work done under this contract (without allowance for profit) of []

1/ References: a. Ltr to DD/P from D/R&D Eastman Kodak Co., dtd 15 Aug 58 (CHAL-0303); b. Ltr to DD/P from [] dtd 15 June 60;
c. Memorandum from Director, PIC to Acting Chief, DPD dtd 6 Feb 61.

25X1A

SECRET

See T & P Section
for foot note references.

~~SECRET~~

IDEA-0164-61

Copy 1 of 5

25X1A

After [] audit at our request 2/ and review by the DPD Contracting Officer, the latter has determined that the Contractor incurred acceptable overall costs amounting at least to []. Accordingly, there is no doubt that the Contractor has incurred excess unreimbursed costs of at least [].

25X1A

25X1A

5. Eastman's Statement of its Claim. The Contractor's Director of Research and Development, [] has described the Company's excess costs as follows: 3/

25X1A

"In my ... letter of August 15, 1958, I included an estimate of the reproduction costs of the equipment actually delivered. In this estimate, engineering costs are assumed to be zero and absolutely no allowance is made for costs of any back-up program apparatus. No consideration is given, either, for the more than [] worth of development expense borne entirely by Kodak. Since this tabulation of reproductive costs, compiled in this manner, shows that the contract price given in EQ-1806 falls [] short in payment to us, we feel that the adjustment which should now be made is at the very least the [] amount. If settlement were made on a strictly CPTF basis, we would be entitled to a recovery of cost, without fee, of []"

25X1A

25X1A

25X1A

25X1A

25X1A

The Government's audit, mentioned above, generally bears out the figures stated in [] letter.

25X1A

6. Eastman's request is based upon the provisions of the Changes Article in the contract. 4/ [] states: 5/

- 2 -

25X1A

25X1A

2/ [] Audit Report dtd 12 Jan 60, file DPD-0315-60, #580

3/ [] ltr dtd 16 Oct 59, file CHAL 0768 (TOP SECRET)

4/ Article 2, "Changes" in the General Provisions of the Contract provides, in pertinent part, as follows: "The Contracting Officer may, at any time, by a written order ... make changes in or additions to drawings or specifications, issue additional instructions, require modified or additional work or services within the general scope of the contract If any such change causes an increase or decrease in the cost of, or the time required for, performance of this contract, an equitable adjustment shall be made in the contract price, or time of performance, or both, and the contract shall be modified in writing accordingly. Any claim by the Contractor for adjustment under this clause must be asserted within 60 days from receipt by the Contractor of the notification of change: Provided However, That the Contracting Officer, if he decides that the facts justify such action may receive and act upon any such claim asserted at any time prior to final payment under this contract. Failure to agree to any adjustment shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled "Disputes".

~~SECRET~~

SECRET

IDEA-0164-61

Copy 1 of 5

"We are now willing to state positively that, in our opinion, changes in performance specification occasioned by changes in requirements of the Government constitute 'changes in or additions to drawings or specifications' and did 'require modified or additional work or services within the general scope of the contract' and we are entitled to consideration in that 'an equitable adjustment shall be made in the contract price'."

Discussion:

7. This memorandum concludes that the Contractor's claim is warranted and that further payment should be made to settle and close out this Contract. The procedural aspect of the Contractor's claim will be disposed of at the outset, followed by discussion of substantive aspects.

8. The Contractor's claim is timely and is properly asserted. The Changes Article in this contract is a standard, normal provision of most government contracts. The rights it gives the Contractor in this case are neither extraordinary nor unusual. While frequently a contractor's request for a "Change Order" is asserted at the time of the alleged change in work, the decided case law leaves no doubt that a claim under this Article may be presented at any time prior to the final payment being made under the contract provided the Contracting Officer is willing to receive it. 6/ In the Eastman case, the Government's file indicates clearly that the Contractor made known his desire to make such a request as early as November 1957, approximately 18 months before delivery and installation/acceptance of the equipment, but the Government's representative then advised Eastman that it desired to have the problem deferred until the conclusion of the work. speaking for the Government, stated: 7/

25X1A

- 3 -

6/ McCord v. U.S. 9 Ct.Cl. 155 (1873), aff'd sub nom. Chouteau v. U.S. 95 U.S. 61, 24 L.Ed. 371 (1877); U.S. v. Corliss Steam Engine Co. 91 U.S. 321, 23 L.Ed. 397, aff'g 10 Ct.Cl. 494 (1874); Whitman v. U.S. 110 F.Supp. 444, 124 Ct.Cl. 464 (1953); Stiers v. U.S. 121 Ct.Cl. 157 (1951); Armstrong & Co. v. U.S. 98 Ct.Cl. 519 (1943). These cases concern a variety of factual situations wherein the Contractors' claims were deferred for good reasons until the completion of the work. These cases deal with situations where the nature of the work undertaken made it necessary for the parties to work with inadequate and changing specifications. In Chouteau v. U.S. the contract involved the changing art of construction of Civil War ironclad monitors; in Whitman v. U.S. the changing requirements in the construction of a World War II chemical warfare center were considered and the Court of Claims was not bothered that the parties did not agree on adjustments to the contract concurrent with each change made in the work since the complexity of the project made it impracticable to sensibly determine equitable adjustments prior to the completion of the entire project.

25X1A

7/ Memorandum for Project Contracting Officer from dtd 10 Feb 58, file SAPC-24217.

SECRET

SECRET

IDEA-0164-61

Copy 1 of 5

25X1A

25X1A

"I have told EK we would proceed slowly and cautiously on this problem since all deliveries have to be made and all costs recorded before we know the magnitude of the problem. We will have to work closely with [] of OCR who is the user of the equipment in our company and will have to furnish any technical justifications. No promises have been made to EK by the Project Director but he did indicate to [] that if he has a good case we might be in a position to furnish 'some relief'."

The Government's contract file contains a draft by Eastman of its proposed claim bearing the date of 22 November 1957. These circumstances lead to the conclusion that the Contractor has met the time limitations laid down by the Changes Article since any so-called delay in presenting his claim is attributable to the Government's decision. The contract remains alive and no "final payment" under the contract has yet been made. The Contractor's claim is not defective from a procedural standpoint and it is entitled to consideration on its merits.

9. A proper interpretation of this contract can best be obtained from an understanding of the circumstances surrounding its inception.

(a) A distinction must be made between the IDEALIST/PIC and the OCR Minicard sets of equipment. Although a considerable number of the component machines are duplicates, the Agency's requirements for these two offices have different histories. The present contract was initiated in June 1955 by a Letter of Intent and the work contemplated related entirely to satisfying the urgent requirements of IDEALIST/PIC. The OCR requirement for Minicard equipment was the result of a study of several years duration in which was sought an improved machine system for the handling of the mass of varied intelligence materials within the library-type functions of that Office. When OCR learned that [] had entered into a research and development contract with Eastman for Minicard equipment intended to solve such a problem, they sought and received authorization to procure a duplicate set of [] equipment. 8/ Originally arrangements were made to procure through the [] but when the IDEALIST/PIC direct contract with Eastman came into existence it became possible to include the OCR requirements therein. This merger of Agency requirements did not occur until several months after the IDEALIST/PIC effort was undertaken by the Contractor.

(b) Since the OCR equipment was to be a duplicate of that being developed for [], Eastman and [] agreed to accept all R&D costs in [] contract, and Eastman agreed to provide the OCR equipment at a fixed price of []. When, later, it was decided to add the OCR equipment to the CIA contract, Eastman stood by its agreement

- 4 -

8/ PRC No. DD/I 239-55, ER 7-0255 (SECRET), 16 May 55.

SECRET

SECRET

IDEA-0164-61

Copy 1 of 5

25X1A

25X1A

to provide the OCR equipment at [] although at that time the actual cost of that equipment had risen to some [] 9/ With respect to the unique equipment being developed for IDEALIST/PIC, the Agency gave Eastman to understand that CIA would pay R&D costs. 10/

25X1A

(c) Both Eastman and the Agency recognized that they were embarking on a research and development program in spite of the nominal fixed price format of the contract. [] stated in this connection: 11/

"The Agency undertook and has brought to a successful operational status one of the most ambitious projects of this generation. ... Success depended not only on technology but also upon absolute secrecy. ... Time was of the essence and the whole effort was carried on in a crash program manner. This forced follow-up on alternative methods, and back-stop apparatus was continuously being built or examined.

"The problem was to perfect in one single endeavor a high-yield reconnaissance system. ... insofar as aerial photography was concerned, the program called for an improvement of at least one order of magnitude in quality of results.

"We were asked specifically to assist in the vehicle film problems and in the entire ground-handling area (film, paper, chemicals, processing machines, printers, viewers, special optics, etc.) and to take on the entire operational job of handling the output product."

(d) With respect to the Minicard equipment systems, both parties were aware that these systems would change in design and in their component parts as the Government and Contractor gained deeper insight into the complexities of assimilating the diverse materials to be photographed, indexed, cross-referenced, filed and recalled on demand. Equipment that would comprehend both visual data and verbal intelligence reports with an encyclopedic range of subjects was recognized as requiring great sophistication in the machines developed. The Agency's technical advisor has commented: 12/

25X1A

- 5 -

25X1A

9/ [] ltr dtd 12 Oct 55 (SAPC-2204), "Fourth list"

10/ Memo for Record dtd 11 Oct 55 (SAPC-2081)(SECRET) from [] Contracting Officer, approved by Project Director, with concurrences by CIA General Counsel and DPD Comptroller.

25X1A

11/ [] ltr dtd 16 Oct 59, file CHAL 0768 (TOP SECRET)

25X1A

12/ [] Memo to Project Director dtd 17 Oct 55 (SAPC-2181) (SECRET).

SECRET

SECRET

IDEA-0164-61

Copy 1 of 5

"In order to make a determination on the extent of Minicard equipment procurement which should be undertaken at this time, it should be borne in mind that the Minicard system is new and checked out in simple prototype form. Resolutions for photographic work are not certain, operating capacities in the complex system are not fully known, and optimum designs for our purposes have not been fully proven. There is no question that the system works and will, over the next several years, become an essential part of the intelligence business."

10. Why a Fixed Price Contract? In the light of the research and development still to be accomplished, the question may well be asked: -- why was this a fixed price contract? The fixed price mechanism was a necessary feature in satisfying the original IDEALIST/PIC crash requirements. The Contractor's facilities to be used for this work were not organized to do cost-type contracting 13/ and major personnel and accounting system changes would have been required. Maximum speed and maximum security were important Government requirements. The fixed price contractual format best served these requirements. However, the parties expected that there would be adjustments within the broadly-stated scope of the work and that commensurate adjustments would be made to the price initially established so as to compensate the Contractor for work performed but not initially contemplated. 14/

11. The Problem of Scope of Work Definition.

(a) A careful review of the contractual documents executed by the Contractor and the Government discloses that Eastman obligated itself to deliver items of equipment which were specifically described only by their functional names and by prices, including a total maximum price. While the parties anticipated that certain standards of machine performance would be achieved, the Contractor made no legally-binding promise as to any particular level of performance of the items to be delivered. The contract contemplated a developmental program which would culminate in the production of the machine components of the Minicard system. The foregoing elements made up the actual scope of this contract.

(b) In the ordinary situation, where the requirements of security and speed are less critical, performance or design specifications are normally to be found in a contract. In this case neither were present. 15/

- 6 -

13/ R&D work was done by one subdivision which then placed orders for hardware to be manufactured by separate plants. The latter traditionally worked only on a fixed price basis.

14/ ltr dtd 16 Oct 59, file CHAL 0768 (TOP SECRET)

15/ A reference in Schedule I of EQ-1806 to "engineering designs" alludes to a prior contract with the Agency (EN-95), but no firm specifications for this equipment resulted therefrom. A reference in Schedule II of EQ-1806 to the effect that the OCR-type equipment should be "in accordance with technical requirements and specifications agreed to" is of doubtful legal significance since the parties did not incorporate any such documents into EQ-1806.

25X1A

SECRET

SECRET

IDEA-0164-61

Copy 1 of 5

(c) Actually the parties intended the OCR-type equipment to be produced in accordance with specifications in the concurrent cost-type R&D contract AF30(602)-1188.

(d) If it is possible to take the view most favorable to the Government, that although the Government failed to incorporate [] specifications into the instant contract the parties actually intended those specifications to govern the work under this contract, nevertheless it must be recognized that those specifications were not goals which the Contractor promised to achieve. Rather, they were design guides which only served to identify desired objectives. ^{16/} The parties clearly recognized there were intangibles to be dealt with in this undertaking. To bring this dilemma within the framework of a written agreement they chose the only device available, namely, to identify their goal and in addition to state what they initially knew about how to reach that goal by way of descriptions of the functioning of the component machines. The parties knew that modifications were inevitable, and within the limits of the funds obligated the Government was prepared to pay for such modifications. The Government wanted to receive ultimately equipment which had benefited from all the modifications incorporated during the development and production phases of the work.

(e) It is well understood in R&D contracting that a contractor is required only to exert his "best efforts" to reach stated goals which in fact ultimately may turn out to be unachievable. Eastman was not legally bound in EQ-1806 to fulfill [] specifications. Eastman was legally bound in EQ-1806 only to use its "best efforts" to meet those specifications within the overall funds made available by the Government. The Contractor has fully met this requirement.

12. OCR and PIC initially recommended against making any further payment to the Contractor on the ground that the equipment delivered did not perform up to the "promised" specifications. ^{17/} Technical difficulties have caused parts of the equipment to operate with less capability than was anticipated. It is believed, however, that the OCR and PIC original views were based on their misunderstanding of the scope of work required of the Contractor. Although Eastman did not in all respects fulfill [] specifications, the evidence is convincing that the Contractor has gone far beyond what he was legally required to do under Contract EQ-1806 in attempting to resolve developmental problems. The expense from this added effort by the Contractor gives rise to the present claim. The Agency's file gives evidence that its

- 7 -

^{16/} The more than three-fold increase of R&D costs under [] contract, from [] is evidence that the original concept of that work changed markedly as sophistication was added to the system during the course of development.

^{17/} AD/CR Memo to DPD Contracting Officer dtd 9 Sept 59; PIC Memo to DPD dtd 10 Sept 59.

SECRET

SECRET

IDEA-0164-61

Copy 1 of 5

representatives requested or acquiesced in the additional work and were aware that the cost ceiling in this contract was being exceeded thereby. 18/ At the present time, both sets of Minicard equipment have been permanently installed in PIC. It is our understanding that they are functioning satisfactorily and make an indispensable contribution to the work of that organization. We further understand that while improvements in the state of the art can be visualized, for the next several years these machines represent the best equipment presently available to perform the functions for which they were designed. These views have been furnished by the Director, PIC in his memorandum to Acting Chief, DPD dated 6 February 1961.

13. The amount of an equitable adjustment. The dollar amount of an equitable adjustment has been carefully considered. Detailed technical information has been obtained from the Contractor to explain the additional work performed. 19/ The overlapping nature of the work done under [] and Agency contracts has made it impossible to know with certainty how R&D costs should be apportioned, bearing in mind that [] was to be charged with R&D costs on the OCR-type equipment and the Agency was to be charged for such costs on the PIC-type equipment. 20/

25X1

25X1

14. To offset this uncertainty, the opinion of the Agency's original technical advisor, [] since resigned, has been obtained. He visited the OCR and PIC installations to compare the equipment delivered with that contemplated in the original contract. Subsequently he wrote a letter 21/ expressing the view that "the excess costs involved in this instance would be somewhere in the range between a half million dollars and somewhat over a million dollars." The Deputy Director (Plans) is also in a position to express an opinion since he has followed the technical development of this equipment closely from the outset. We understand that DPD personnel and the DD/P are in agreement that [] is an appropriate amount to offer the Contractor. In our opinion such an offer has adequate justification and support from the data in this file.

25X1A

LAWRENCE R. HOUSTON
General Counsel

- 3 -

18/ Ltr to DD/P from D/R&D Eastman Kodak Co. dtd 15 Aug 58 (CHAL-0303), (Attachment 1 hereunder)

19/ Ltr to DD/P from D/R&D Eastman Kodak Co. dtd 9 Oct 58

20/ [] DPD Contracting Officer Memo for DD/P dtd 9 Dec 59 (DPD-8309-59)(SECRET)

21/ Ltr to DD/P from [] dtd 15 June 60.

SECRET

SECRET

IDEA-0164-61

Copy 1 of 5

25X1A

OGC:LRH: (8 February 1961)

Distribution:

- Cy 1 - AC/DPD
- 2 - DPD/Contracts
- 3 - DPD/OGC
- 4 - DPD/RI
- 5 - OGC

*The documents referred to
in the footnotes of this
memo are indexed and
filed in the T & P
section of this file.*

SECRET